Supreme Court, U.S.
FILED
6 2001
CLERK

No. 00-1473

IN THE

Supreme Court of the United States

ARTHUR GOLDSTEIN and
MEDCO ADMINISTRATORS, LTD.,

Petitioners,

v.

ELAINE L. CHAO, Secretary of Labor,
United States Department of Labor,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

Petitioner Medco states that there is no parent or publicly held company that owns 10% or more of the corporation's stock.

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STATEMENT

The Acting Solicitor General ("Government") filed a brief ("Opposition Brief") on behalf of respondent, Elaine L. Chao, Secretary of Labor, United States Department of Labor ("DOL"), in opposition to petitioners' Arthur Goldstein's ("Goldstein") and Medco Administrators, Ltd.'s ("Medco") Petition for a Writ of Certiorari (referred to collectively as the "petitioners"). This brief is submitted in reply to the Government's brief.

A. The Government's Opposition Brief Supports Petitioners' Argument That The Supreme Court Needs to Grant Certiorari In Order To Establish The Standard to Apply In Determining What Constitutes Plan Assets.

The fundamental issue in this case is whether the fees paid to Medco by employers in consideration for services provided by Medco to the employers constituted assets of the SOLO Benefit Fund (the "Fund"). In their Petition for a Writ of Certiorari, petitioners contend that there is no consistent or logical standard for determining whether fees paid to employer representatives, such as Medco, constitute plan assets. This argument has two components. First, the standard applied by the Second Circuit in answering this question focused solely upon the "governing documents" and clearly conflicted with the "functional" approach adopted by the Ninth Circuit. Second, the "governing documents" standard utilized by the Second Circuit in this case is so nebulous that it provides no standard at all.

The petitioners contend that the appropriate standard that should be adopted is one in which courts examine both the relevant documents that create the trust fund and which define the parties' relationship as well as the economic and practical realities of the parties' relationship. This approach is similar to the standard adopted by the Ninth Circuit. *See Acosta v. Pacific Enterprises*, 950 F.2d 611 (9th Cir. 1991); *Kayes v. Pacific Lumber Co.*, 51 F.3d 1449 (9th Cir. 1995).

The Second Circuit, in rejecting the approach urged by petitioners, instead relied solely upon a consideration of the

documents that govern the Fund in determining whether Medco's fees are plan assets.[1] In its Opposition Brief, the Government argues that the standard employed by the Second Circuit is correct. The standard applied by the Second Circuit, and urged by the Government, however, is flawed in several important respects.

1. The Government's Position That The Governing Documents Test Is The Appropriate Standard, And That A Functional or Economic Realities Test Should Be Rejected, Is Inconsistent With Its Previous Positions In This Case.

The Government states in its Opposition Brief that the DOL has "accepted" a governing documents test and that it has advocated this position throughout this case Gov't Opp. Brief 7.[2] The Government further states that it "did not suggest that a 'functional' or 'economic realities' approach be used in determining whether employer contributions were plan assets." *Id.* This is, quite simply, not true.

The DOL included in its memorandum of law in support of its motion for summary judgment before the District Court a section titled "a. The functional or economic realities analysis." In its introduction to this section, the DOL wrote that "[I]n determining whether or not a particular item constitutes a plan asset, the Courts have generally utilized two approaches: (1) a functional or economic realities analysis; and, (2) an examination of the governing documents." The DOL then urged the District Court to adopt the functional or economic realities approach utilized by the District Court in *Reich v. Polera*

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1. In affirming the District Court's finding that the fees paid to Medco are plan assets, the Second Circuit relied "substantially for the same reasons stated in Judge Wood's Opinion and Order . . . analyzing the terms of the documents governing the Fund" *Herman v. Goldstein, et al.*, 224 F.3d 128, 129 (2d Cir. 2000) *See also* Petition for Writ of Certiorari, at App. A).

2. "Gov't Opp. Br. __" followed by a number refers to the page number in the Government's brief in opposition to the Petition for Certiorari.

Building Corp., 20 EBC 1100 (S.D.N.Y 1996) in which a question similar to the one at bar was presented. The DOL further extolled at length the merits of the functional or economic realities analysis as applied by the Ninth Circuit in *Acosta* and *Kayes*. The DOL next applied this functional or economic realities analysis to the facts of the instant case and urged the District Court to adopt this approach.

For the Government to suggest, as it now does, that in doing the foregoing it simply "informed" the District Court of the existence of the functional test, but "did not expressly endorse the functional one" is both an attempt to hide from the facts of this case and to mask the fact that there exists no clearly defined and consistent standard to apply in determining whether particular monies constitute plan assets (See Gov't Opp. Brief at fn. 2).

The inconsistent positions taken by the DOL and the Government serves to highlight the need for the Supreme Court to resolve the conflict among the Courts as to the test to be used to determine what constitutes plan assets.

2. The Governing Documents Test, As Applied By The Second Circuit, Is In Fact No Standard, And Is Fundamentally Flawed, As It Does Not Address Which Documents Are To Be Considered Or What Weight Is To Be Given Any Particular Document.

The Government's argument, that the governing documents test as applied by the Second Circuit was correct, is flawed for several reasons. The primary difficulty with the governing documents test is that it fails to establish any guidelines or instruction as to which documents are to be considered and which are to be ignored as well as the relative weight to be given the documents considered. As a result, certain documents may be considered as relevant by one court while another court may chose to ignore the same document, or may accord the document vastly different importance. This invariably leads, as it did in the instant case, to an arbitrary and inconsistent application of the test.

For example, the District Court, and thus presumably the Second Circuit, ignored many important aspects of the collective bargaining agreements entered into between the Solidarity of Labor Organizations (the "Union" or "Local 947") and Medco's employer clients. The District Court, and thus presumably the Second Circuit, further completely ignored other significant documents, such as the Authorization of Collective Bargaining, the document that served as the retainer between Medco and its employer clients. As discussed in Petitioners' Petition for Writ of Certiorari, these documents lend great support to petitioners' argument that Medco's fees are not plan assets.

The failure of the Second Circuit to consider all aspects of the collective bargaining agreements, and to instead rely upon only a few select passages, is without justification. Edmund Perez ("Perez") was both the President of Local 947, the labor organization that entered into the collective bargaining agreements with Medco's employer clients, as well as a trustee of the Fund. Accordingly, Perez was familiar with the terms of the collective bargaining agreements. By accepting contributions pursuant to these collective bargaining agreements, the Fund impliedly, if not expressly, ratified and agreed to the terms of the collective bargaining agreements as they related to the Fund. Thus, the collective bargaining agreements must be read, in their entirety, *in pari materia* with the trust indenture, which they were not.

Another example of how the governing documents test leads to the exclusion of relevant evidence as to whether Medco's fees are plan assets is that the Government argues that the Authorization of Collective Bargaining Representative should be disregarded. The Government contends that since this document "is not a 'contract to which *the plan is a party* [citations omitted]', it does not alter the plan's rights as set forth in the plan's trust agreement." Gov't Opp. Brief 8. The Government's position, which it takes for the first time, that no document can be considered unless the plan is a party to that document, is inconsistent with its position in this case, court

decisions and various statutes. Under this approach, even the very document that establishes the plan's right to contribution, the collective bargaining agreement, would not be considered because the plan is not a signatory to the collective bargaining agreement. Excluding the collective bargaining agreement, however, would contradict the Supreme Court's holding in *Central States, Southeast and Southwest Areas Pension Fund v. Central Transport, Inc.*, 472 U.S. 559 (1985) that the collective bargaining agreement is a relevant document that must be examined in order to determine the Fund's rights under ERISA. By arbitrarily considering some documents "governing documents" and others not "governing documents," the Government advocates a test which is arbitrary and, thus, inherently flawed.

Further, the approach adopted by the Second Circuit and advocated by the Government ignores the fact that Medco was the employers' collective bargaining representative. Perhaps the Government disregards the Authorization of Collective Bargaining Representative because this document establishes that Medco was the employer's representative, that Medco acted on behalf of the employers and that it was entitled to fees for its services for the employers. Moreover, while the Government may *argue* that the employers agreed that the monies paid to Medco were intended by the employers to plan assets, there is not a scintilla of evidence that the employers intended that these payments constituted plan assets or were considered as such by the employers. In fact, the contrary is the case. The record is clear that the employers did not intend that their payments to Medco be considered plan assets. The Government can only make this argument because it ignores the Authorization of Collective Bargaining Representative which establishes Medco's entitlement to its fees.

3. The Mechanical Application Of The Governing Documents Test, Looking Only Primarily At The Trust Indenture For Guidance, Leads To Both An Illogical And Unlawful Result.

The mechanical application of the governing documents test, looking only at the trust indenture for guidance, leads to both an illogical and unlawful result. Under the reasoning adopted by the Second Circuit, all sums sent by employers to Medco are plan assets. However, included among these amounts, in addition to contributions required by the Fund and Medco's fees, were Union dues checked-off from employees' wages to be remitted to the Union. According to the analysis adopted by the Second Circuit, the union dues, sent by employers to Medco and forwarded from Medco to Local 947, are plan assets. Thus, the Local 947 officials or even payroll clerks that accepted the union dues and deposited these amounts into Local 947's account are no less Fund fiduciaries than Medco and Arthur Goldstein by virtue of the fact they exercised discretionary control over plan assets in depositing the union dues into the union's accounts.

It also would have been illegal for Medco to remit to the Fund Local 947 union dues and initiation fees checked-off from employees' wages. Monies deducted from employee's wages are held in trust for remittance to Local 947. It would have thus been unlawful for Medco to remit these amounts to any entity other than Local 947. Additionally, the Fund would have been in violation of ERISA and the terms of its tax exempt status had it accepted amounts beyond those amounts it required employers pay for the provision of benefits. The Fund may not simply collect monies in addition to the amounts it sets for employers to pay for the provision of benefits.

Accordingly, petitioners have been ordered to pay over to the Fund amounts (i.e., Medco's fees) that the Fund could not have lawfully accepted had they been tendered by petitioners to the Fund at the time petitioners received them from their employer clients. This illogical, but inescapable, conclusion is

the result of the mechanical application of the governing documents test ignoring the functional and economic realities of the parties' relationship.

The Government's approach also disregards the economic and practical realities of the parties' relationship. The Government and the Second Circuit simply disregard that Medco was the collective bargaining representative for the employers.

This is not a case where the Fund was pillaged or benefits were denied to participants. Rather, the opposite is true; the Fund thrived during the time Medco represented the employers. Medco performed a very valuable service for its clients for which it had negotiated, and was entitled to receive, a fee. Neither the Fund, Local 947, Medco nor the employers ever considered Medco's fees to be plan assets. Moreover, a fair review of the relevant documents and the functional and economic realities of the parties' relationships clearly proves that Medco's fees were not, and could never be considered, Fund assets. Yet, the Second Circuit, ignoring these facts and relying instead solely upon the Fund's trust indenture and a few selected passages from the collective bargaining agreement, concluded that Medco's fees are plan assets. This conclusion, in light of the vast evidence to the contrary ignored by the Second Circuit, is both arbitrary and unjust.

In sum, the Supreme Court must adopt the standard advocated by the petitioners which will take into account the realities of the relationship between the parties.

B. The Government's Opposition Brief Provides Further Support That The Second Circuit Misinterpreted And Misapplied The Law Regarding The Conduct That Makes An Individual A Fiduciary Under ERISA.

In its Opposition Brief, the Government alleges that petitioner Goldstein is personally liable for all the fees that Medco received resulting from Goldstein breaching his fiduciary duty. Under ERISA, the DOL's regulations and this Court's decisions, an individual can only be held liable as a fiduciary to

the extent that he exercised authority or control regarding matters relating to an ERISA plan. 29 U.S.C. § 1002(21)(A); 29 C.F.R. 2509.75-8, FR-16; *Mertens v. Hewitt Associates*, 508 U.S. 248 (1993). Thus, Goldstein can be liable as a fiduciary only in those instances where he set personally Medco's fees.

The Government's sole proof that Goldstein set Medco's fees is based on Goldstein's deposition taken on July 18, 1996. Goldstein was asked by the DOL who set Medco's fees "at that time." Goldstein responded "Me." The Government claims that Goldstein's answer is most "naturally read as an admission that he set fees during the time that he was President [of Medco]" Gov't Opp. Brief 11-12. The petitioners believe that Goldstein's answer cannot be "naturally read" to mean that "at that time" referred to the time period that he was President. There is simply no reference in the subject question, or any of the preceding questions, to the period that Goldstein was President. The phrase "at that time" is ambiguous and could refer to any time period before the deposition.

Faced with no evidence of any specific instances in which Goldstein set Medco's fees, the Government argues that the petitioners presented no proof that someone else set Medco's fees Gov't Opp. Br. 12. In effect, the Government is now arguing, for the first time, that the Government does not have to prove that an individual has committed the acts for which he is alleged to be liable, but that the individual must prove that he did not commit the acts. This proposition contradicts the fundamental nature of this country's system of jurisprudence that a plaintiff in a civil action must prove its case rather than a defendant having to disprove the plaintiff's allegations.

Moreover, Goldstein was found liable for the period from March 1, 1991 through February 28, 1997. Since Goldstein's was no longer Medco's President in March, 1996 and since Goldstein's deposition was in July 18, 1996, the Government, again for first time, is forced to raise new arguments on how Goldstein could be liable after March, 1996 and after July 18, 1996. The Government alleges that Goldstein

would be liable in all instances where he did not set Medco's fees because he "knew of Medco's breaches and either enabled Medco to commit them or failed to remedy them [citations omitted]" Govt. Opp. Br. 12. The Government further alleges that Goldstein is liable because he retained "indirect control" over Medco because his brother became Medco's President and his spouse and sister-in-law where the sole shareholders. *Id.* The Government never explains how Goldstein retained indirect control because of his relationship to these individuals or what control Goldstein retained. These new arguments by the Governments were never presented to either the District Court or the Second Circuit. Moreover, there is no proof in the record to substantiate that Goldstein knew of any, some or all of Medco's breaches, enabled Medco to commit the breaches or exercised indirect control over Medco. At the very least, there are triable issues of fact regarding these new allegations.

C. A Permanent Injunction Should Not Have Been Granted Against Goldstein

In its opposition brief, the Government argues that a permanent injunction was properly granted, without a hearing, against Goldstein because Goldstein's conduct was not in dispute. Goldstein's conduct, however, is in dispute. Moreover, the Government never states what the standard should be for granting a permanent injunction.

The petitioners argue that the permanent injunction was improperly granted without a hearing. As indicated, *supra*, there is a dispute as to the role Goldstein played in setting Medco's fees as well as the time period involved in which he may have set the fees. Moreover, the Government states that Goldstein's action were intentional and demonstrate a "continuing insensitivity to ERISA's requirements" Gov't Opp. Br. 13. Whether Goldstein intentionally violated ERISA is a fact question which requires a hearing. In addition, there is no evidence that Goldstein had or has a "continuing insensitivity" toward ERISA *Id.* In fact, Goldstein was no longer Medco's President after March, 1996. Thus, there is at least a factual question of Goldstein's alleged "continuing insensitivity." *Id.*

An issue also exists regarding the standard that should be used by a court to issue a permanent injunction. The Government does not indicate the standard that should be used. One of the reasons that the Government does not advocate a standard is that under any standard that it proposes, the Government's position would be inconsistent with that standard because of the fact that it did not seek to have the Trustees of the Fund, all of whom knew what Medco was doing and approved of Medco's actions, removed as Trustees while it sought to have Goldstein permanently enjoined from providing services to any ERISA plan. The petitioners believe that a permanent injunction can be issued only where a party has engaged egregious misconduct in violation of ERISA, of which there is no evidence in this case.

The petitioners contend that the Supreme Court must require that a hearing be held before a permanent injunction be issued where there are triable issues of fact. The Supreme Court also must hold that a permanent injunction can be issued only where a party has engaged in egregious misconduct in violation of ERISA.

CONCLUSION

For the foregoing reasons, it is respectfully requested that the Supreme Court grant certiorari in this matter.

Respectfully submitted,

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